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Procedia - Social and Behavioral Sciences 44 (2012) 446 – 452

Procedia
Social and Behavioral Sciences

Financial services in terms of changing environment

Functioning of investment funds in Republic of Macedonia in terms of changing environment

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Abstract

This paper deals with the functioning of investment funds in terms of changing environment. Investment funds are financial institutions which have a particularly important role in capital markets in many countries and they have become major players affecting numerous events both inside and outside financial markets.
The analysis of the participation of investment funds shows that their presence and circulation by regions is different. Namely, they are present in the U.S. and in Europe to a great extent, followed by Africa and Asia.
In recent years, we have seen a trend of increased investment in investment funds in transition economies, as opposed to classical saving (9.4 billion U.S. $ in Poland, 4.2 billion U.S. $ in the Czech Republic, 4.1 billion U.S. $ in Hungary and 1.4 billion U.S. $ in Slovakia). Investment funds in the financial system of the Republic of Macedonia were established in 2000 with the Investment Funds Act. In fact, due to the movement of stock exchange, which has had downward trend since 2007, the postponement of Macedonia's entry into NATO, and the global economic crisis, the functioning of investment funds has shown changeable trends of declining growth in the number of shares issued, net assets value of funds, and the price of shares.
This paper will present statistical analyses of the functioning of three investment funds in Macedonia in terms of changing environment as a result of the movements in the overall economy, and will offer some directions and measures for their improvement.

***Index terms*—Investment funds, functioning, development, changeable trend, movement of yield**

Key words: Investment funds, development, regulative, movement of number and price of issued shares.

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1877-0428 © 2012 Published by Elsevier B.V. Selection and/or peer review under responsibility of the Faculty of Tourism and Hospitality
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1.Introduction

The aim of this paper is to provide an overview of the functioning of investment funds in terms of changing environment. This paper is structured in three parts. The first part focuses on the functions and tasks of investment funds. The second part addresses the issue of the functioning of investment funds in the world in terms of changing environment with an overview of the amount and percentage of investment in funds. The third part focuses on the functioning of investment funds in terms of changing environment in the Republic of Macedonia. The paper concludes by discussing the reasons for their slow development and offering directions for their further development. Investment funds are financial institutions which have a particularly important role in the capital markets in many countries, some of which have become major actors in capital markets influencing numerous events both inside and outside them.

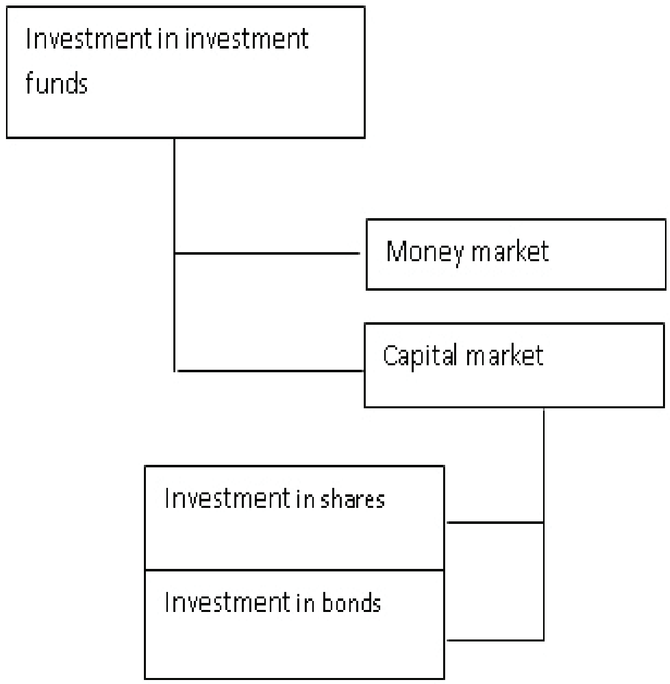
This type of institutions are most widely organized in developed countries, especially in the U.S., not only in terms of the total capital they manage, but also in terms of a very rich range of different funds, large and branching networks of distribution channels, by which the shares are placed, and legislation is formulated, i.e. supervisory bodies and organizations that monitor their work. Europe has developed capital market and investment funds, and most of the Member States of the European Union, work together on the harmonization of legislation in the individual countries in the region. That's why the aim of the developed so-called UKTIS (UCTIS) funds or open-end investment funds intended for the public, and according to the definition accepted by the EU, is to achieve harmonization of the various names and definitions in different Member States.

In transition economies, investment funds are in an initial development stage and such development is a consequence of the privatization process. Macedonia is still in the inception stage of the operation of this type of funds.

2.Functions and tasks of investment funds

Investment Funds in market economies play a key role in the functioning of the market in general and in the development of the capital market. Their role is particularly manifested in the stability in the development of capital markets and mobilization of capital. Their general significance lies in the enrichment of the institutional structure of the banking-financial sector, the increase of the competition and the provision of a modern approach to market transactions. Investment funds are a modern form of financial institutions in the capital market or a new type of financial intermediaries, which occurred as a result of the rapid development of capital markets in industrialized countries, because the existing banking system was a barrier to their further development.

Investment funds are financial institutions or institutional investors, which collect funds from their depositors, then place them in short or long-term investment, in various financial forms. Investment funds are financial institutions which draw funds from small individual investors, and in turn issue shares in the financial assets of the fund. Funds created in this way are then invested by investment companies in the domestic or international financial market, in the form of various securities, while achieving diversification of investment. A manager or a team of professionals are is responsible for efficient investment in funds, representing a portfolio management company. This entity within the investment company is called the investment adviser or financial adviser according Markovski [1].



Scheme 1. Investment in investment funds

In general, investment funds enrich the institutional structure of the banking-financial sector, encourage saving and efficiency investments through investments in profitable securities. Thus, the concept of investment funds, as a representative of the so-called collective investment schemes, is based on the following arguments:

- Collection and concentration of small amounts of cash by a large number of people;
- Reduction of the risk of individual investment, and
- Greater overall efficiency of the investments because asset management is entrusted to a professional, efficient and high quality management team.

The basis of the operation of investment funds consists of collecting capital, mainly through the sale of shares or documents of shares to potential investors.

Thus formed financial potential funds place their capital in stocks and bonds of companies in the country, as issuers of securities, primarily to facilitate the process of buying securities from the population.

The investment fund has the ability to diversify its portfolio by investing in securities of companies with different risk in different industries, geographic regions and so on, depending on the objectives of each fund separately. According Pendevska[2], the legislation, with simultaneous establishment of effective mechanisms of control and supervision of their work is essential especially for acquiring and maintaining confidence among broad layers of potential participants / savers in their stability and solvency, as well as competence and honesty of members of managerial teams.

The basic reasons for the dynamic growth of investment funds and their increased popularity among small investors are the following:

- They provide relatively high yields (higher than term savings deposits);
- They are relatively safe (due to the diversification of the portfolio), and
- They have a high degree of liquidity (since the fund's shares may be sold in the capital market, depending on the fund).

3. Functioning of investment funds in the world in terms of changing environment

The Analysis of the participation of investment funds shows that their presence and circulation by regions is different. Namely, they have great presence in the U.S. and in Europe, followed by Africa and Asia. The structure of investment in funds is different with predominant investments in shares (45%) in bonds (20%), while the rest is invested in mixed funds. This structure varies widely across regions or countries. Thus, in U.S. funds dominate the shares funds with 50% of market share, while in EU countries the share is around 36%. In transitional economies bonds funds are dominating, with the exception of the Czech Republic and Croatia, which have the largest share of money market funds.

In transition economies, in recent years, we have seen a trend of increased investment in investment funds, as opposed to classical saving. For example: according to recent statistics, investments in mutual funds are: 9.4 billion U.S. $ in Poland, 4.2 billion U.S. $ in the Czech Republic, 4, 1 billion U.S. $ in Hungary and 1.4 billion U.S. dollars in Slovakia. Because of the global economic crisis the world will remember the year 2009, which was marked by the decline in the value of net assets worldwide, and the loss of funds with a threat of liquidation. The statistical analysis of the Investment Institute at the end of 2009 in the United States shows that 700 funds are liquidated, which amounts to 7% of the total funds in the U.S..

4.Functioning of investment funds in Republic of Macedonia in terms of changing environment

The key problem in Macedonia regarding the establishment of investment funds is the process of privatization in the country. The "insider privatization" implemented here, did not create real change within companies. Namely, in most companies, adequate capital was not invested to make some significant changes. Unlike other transition economies, where mass privatization was carried out by issuing vouchers in the form of share value, with citizens' equal participation in the privatization process, in the Republic of Macedonia the privatization of enterprises was implemented with purchase by employees, management buyout, sales of the ideal part, organization of public calls for proposals or direct negotiations, purchase of the company, issuing shares, further venture and conversion of the claims of creditors in equity, written in Law for transformation of companies with public capital [3]. As a result of the privatization of companies, many of them are still closed.

And, as it is known, the functioning and the operation of investment funds should contribute to: encouraging saving, concentration and efficient allocation of capital, financial market development, appropriate regulation, development, and creation of new financial instruments, institutions, raising the awareness, in other words, the development of the overall financial infrastructure. The usefulness of the existence of investment funds and their impact on the economy can be simplified into the following assumptions:

- Increase of the total savings;
- Completion of the privatization process;
- Reduction of the dependence on unstable sources of funding.

In Macedonia the establishment and operation of investment funds is regulated by the Investment Funds Act, enacted in 2000. Even though there is a legal basis for establishing investment funds, whose presence in the capital market is necessary because of the fact that they encourage saving, enabling the concentration and allocation of capital, however, the first investment fund was established only in November 2007. By early 2008 in the Republic of Macedonia three investment funds began to work (SEE Illyria, Illyria Global emerging markets, open investment fund Innovo Stock Status). Analyses show that there are several factors limiting the development of investment funds, the most significant being: the high amount of money which should necessarily be collected in its portfolio, the strict procedures for foreign exchange operations, the ban on investment in securities traded on foreign stock exchanges, the lack of investment in real estate and so on. Since the beginning of their establishment, and throughout the entire period of their operation, three funds in the Republic of Macedonia have realized negative rate of return, except in July 2008 when stabilization of securities market occurred, which was again followed by a downward trend rate of return in the following month. Moreover, it should be always taken into consideration that the yield of the fund depends primarily on the yield of the securities that the fund owns, i.e. yield (trend) of the capital market. Two years later, in 2009, there were nine investment funds operating in the Republic of Macedonia, managed by six management companies and funds: Ilirika Fund Management manages Ilirika Southeast Europe and Global emerging markets, Innovostatus - Status of Innovo stock, KD - KD by KD Brick and South Balkans My Fund - With My Fund, Sava Invest - with growing and Sava Balance and KB Publikum Invest - with KB Publikum balanced.

According to statistics in the Republic of Macedonia[4], investment in mutual funds since the beginning of their operation is one euro per capita, which is quite law compared to other countries in the region (6 € in Serbia , 550 € in Croatia and 1300 € in Slovenia).

At the beginning of the operation of investment funds in the Republic of Macedonia, the world faced a financial crisis. The global economic crisis began in 2007 and grew into recession with the beginning of the financial crisis in the U.S. due to mortgage crisis, which led to the collapse of the U.S. financial system.

Due to the decline of the real estate market in the U.S., banks are not able to collect their claim, thus facing a loss in their operations. All this creates a crisis in the world decline of the financial system, reduction in credits supply, and as a consequence the world enters a recession [5].

Investment Funds in the Republic of Macedonia started to work exactly at the beginning of the global crisis. By that time, the Macedonian Stock Exchange was playful thanks to foreign investors, and had a major impact on the domestic capital market. When foreign institutional investors, realized that the crisis was on the threshold, they started to draw large capital gains from domestic capital market. They created growth in the prices of shares on the Stock Exchange, and later with the onset of the global crisis they created fall of stock prices, because of their withdrawal from the Macedonian market. The participation of foreign investors in the stock market total turnover in 2007 amounted to about 65% and the next year at the beginning of the crisis, due to the losses they suffered on their domestic markets, their share was around 22%. Statistics show that global stock indexes fell by 50%, and the Macedonian stock exchange

MBI 10 index fell by 80% in that period, with 10,000 index points in 2007 compared to 1,700 points in 2009.

Because of the crisis in the fund industry worldwide, the unit share price of 100 denars in 2007 fell to 32 denars per share in 2009, followed by a decline in the value of net assets of the funds in the Republic of Macedonia. Investment funds in the Republic of Macedonia registered a loss of about 22%. The downward trends of declining funds worldwide were transferred in regional markets, and also in the Macedonian capital market. In the first half of 2009, the Company Management Prospekt Invest Fund closed down because of large losses, and by the beginning of 2010 three investment funds were liquidated. By the first quarter of 2009, the net assets of all funds in the Republic Macedonia were 1,347,228 euros.

Table 1. Yield of investment funds in 2009 and 2010

Open Investment funds	Yield from 01.01.2010 to 31.12.2010	Yield for a period of one year in time of crises
ILIRIKA JIE	2,98%	-13,17%
ILIRIKA GRP	13,09%	7,71%
INNOVO STATUS	-16,33%	-27,16%

Source: Source: authors' calculations

As can be seen from the table, the impacts of the global economic crisis lingered throughout 2010 with a negative return on operating funds, but in 2009 80% more capital or 2.5 million euro were invested in investment funds compared with 2008.

In fact the global financial crisis is not the only factor influencing the movement of the investment funds in Macedonia. It is also due to the movement of stock exchange, which has had a downward trend since 2007, the postponement of Macedonia's entry into NATO, the global economic crisis, the functioning of the investment funds changeable trends of declining growth in the number of shares issued, net assets value of funds and the price of shares, etc.

5.Conclusion

In the changing financial environment you need to know the famous saying that you should not invest without sufficient analytical financial information because the time of cheap capital has gone long time ago. Investment funds as financial institutions have a particularly important role in the capital markets in many countries and depend on the environment in financial capital markets.

Because of the global economic crisis the world will remember 2009, with a decline in value of net assets worldwide and loss of funds with threatened liquidation.

Investment funds in our country have not met the expectations of the capital market and have brought into question their survival, and the companies by which they are managed. That happened because of the financial crisis, the economic situation in the country, Macedonia's postponed entry into NATO, the small supply of securities, the insufficient advertising of investment funds, the lack of awareness of the population about the benefits of investing in investment funds, the lack of modernization of the stock market, the openness of companies, better protection of small shareholders and the increase of the shareholder rights and so on.

The future development and improvement of investment funds in Macedonia should be looked for in the following directions and measures:

- Reduction and elimination of credit risk in the Macedonian economy;
- Establishment of a network of well-educated investment advisers;
- Effective supervision, aimed at building confidence among investors;
- Modernization of the stock market;
- Greater openness to stock companies;
- Organization of seminars by funds and investment companies that manage them to inform and educate the population, to advertise their work, and thus to become closer to the smallest investors;
- Income tax relief for individual investors;
- Harmonization of legislation of the Republic of Macedonia with the European legislation;
- Adoption of amendments to the Investment Funds Act for the purpose of regulating the following issues:
- precise definition of the term investment fund as an investment company that invests in equity securities;
- Drafting an Investment Advisers Act, and fixing/ specifying the advisers', participation in the mediation of investment funds;
- Not having a precise regulations for investment abroad at the moment, it is necessary to regulate investment in offshore centers or selling shares in such funds in the Republic Macedonia;
- Greater transparency of open investment funds that are not listed;
- Ability to transfer funds from one fund to another, which is managed by the same company management;
- Transfer of assets or shares to a second person with the approval of the management company;
- Ability for transfer from closed to open investment funds etc.

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